June 16, 2021

BIR RULING NO. S40M-210-21

Sec. 40 (C) (2)

DPA Law
Unit H, 7th Floor, Westgate Tower
1709 Investment Drive, Madrigal Business Park
Barangay Ayala Alabang, Muntinlupa

Attention: *AAA and BBB*

Gentlemen :

This refers to your letter dated June 27, 2019, which was indorsed to this Office by Revenue Region No. 6, Manila on July 23, 2019, requesting on behalf of your client, Philippine Kho's Association, Inc. for a ruling on whether the merger between two (2) non-profit civic associations/organizations and consequent transfer of the property to your client is taxable.

It is represented that on September 25, 1998, a merger between Philippine Kho's Association, Inc. and Lunar Civic and Fraternal Association, Inc. took place with the former becoming the surviving entity; that Philippine Kho's Association, Inc. and Lunar Civic and Fraternal Association, Inc. are both non-stock corporations; that pursuant to the merger, no shares or dividends shall be issued to the members or board of trustees of the absorbed entity; that as a consequence of the merger, a certain real property was transferred in favor of Philippine Kho's Association, Inc.; that the property involved is covered by Transfer Certificate of Title (TCT) No. _____ the "Property" with an area of 576 square meters located at 1146 Narra Street, Tondo, Manila and currently registered under the name of Lunar Real Investment Corporation (now: Lunar Civic and Fraternal Association, Inc.); that sometime in 2014, the then Board of Trustees of Philippine Kho's Association, Inc. sought to consolidate the title of the Property in its name; that on November 28, 2014, the necessary taxes (capital gains tax and documentary stamp tax) in relation to the merger were paid in order to effect the transfer of the title from Lunar Civic and Fraternal Association, Inc. to Philippine Kho's Association, Inc.; and that upon presenting the payment and other necessary documents to the Revenue District Office No. 29, Tondo, Manila, you were

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informed that the merger is tax exempt and was later advised to obtain the necessary opinion from the BIR head office and/or legal department prior to the issuance of Certificate Authorizing Registration (CAR).

In reply, please be informed that Section 40 (C) (1) & (2) of the National Internal Revenue Code of 1997 (Tax Code), as amended, provides, to wit:

> **"SEC. 40. Determination of Amount and Recognition of Gain or Loss. —**
>
> xxx xxx xxx
>
> (C) Exchange of Property. —
>
> (1) *General Rule.* — Except as herein provided, upon the sale or exchange of property, the entire amount of the gain or loss as the case may be, shall be recognized.
>
> (2) Exception. — No gain or loss shall be recognized if in pursuance of a plan of merger or consolidation —
>
> (a) A corporation, which is a party to a merger or consolidation, **exchanges property solely for stock in a corporation**, which is a party to the merger or consolidation;" (Emphasis supplied)

From the afore-quoted provision of Section 40 (C) (2) of the Tax Code, as amended, it is clear that in order to qualify as an exception to the recognition of the gain or loss upon the sale or exchange of property, a corporation which is a party to a merger exchanges its property solely for stock in another corporation which is also a party to the merger.

As defined, merger pertains to the absorption of one or more corporations by another existing corporation, which retains its identity and takes over the rights, privileges, franchises, properties, claims, liabilities and obligations of the absorbed corporation/s. The absorbing corporation continues its existence while the life or lives of the corporation/s is or are terminated. [1]

In the present case, however, there was no exchange of property solely for stock in another corporation. Pursuant to the merger, Lunar Civic and Fraternal Association, Inc., as the absorbed corporation, transferred its Property to Philippine Kho's Association, Inc., as the surviving corporation, without any issuance of shares of stocks in favor of the members and/or trustees of the absorbed corporation. Although the merger between Lunar Civic and Fraternal Association, Inc. and Philippine Kho's Association, Inc. is a valid reorganization under the Corporation Code, that alone is not sufficient to afford non-recognition of gain or loss obtained in the transaction. Therefore, the provisions of Section 40 (C) (2) of the Tax Code, as amended, is not applicable.

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In view of the foregoing, the merger of Lunar Civic and Fraternal Association, Inc. into Philippine Kho's Association, Inc. does not qualify as a tax-free merger under Section 40 (C) (2) of the Tax Code, as amended, and corresponding taxes should be imposed for dissolution and liquidation.

Very truly yours,

(SGD.) CAESAR R. DULAY
Commissioner of Internal Revenue

Footnotes

1. *Bank of Commerce v. Radio Philippines Network, Inc.*, G.R. No. 195615, April 21, 2014, Phil. 491-581.

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